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No. 89-713

In The

Supreme Court of the United States

OCTOBER TERM, 1989

MOR-FLO INDUSTRIES, INC. and
AMERICAN APPLIANCE MFG. CORP.,

Petitioners,

v.

STATE INDUSTRIES, INC.,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR PETITIONERS

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

I. Statement of the Case 2

II. Argument 3

A. Market Share 3

B. Burden of Proof 8

III. Conclusion 8

PETITIONER'S SUPPLEMENTAL APPENDIX . . . . . A-i

TABLE OF AUTHORITIES

Cases *Page*

Central Soya Co. Inc. v. Geo. A. Hormel & Co.,
723 F.2d 1573 (Fed. Cir. 1983) 7

Cincinnati Gas Co. v. Western Siemens Co.,
152 U.S. 200 (1894) 6

Corporation of New York v. Ransom,
64 U.S. (23 How.) 487 (1859) 6

Dobson v. Hartford Carpet Company,
114 U.S. 439 (1885) 6

Graham v. John Deere Co.,
383 U.S. 1 (1966) 7

Radio Steel & Mfg. Co. v. MTD Products, Inc.,
788 F.2d 1554 (Fed. Cir. 1986) 7

Root v. Railway Co., 105 U.S. 189 (1881) 6

Rude v. Westcott, 130 U.S. 152 (1889) 6

Seymour v. McCormick,
57 U.S. (16 How.) 480 (1853) 6

Water Technologies Corp. v. Calco, Ltd.,
850 F.2d 660 (Fed. Cir. 1988) 7

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REPLY BRIEF OF PETITIONER

This is in reply to respondent's (State's) brief opposing the grant of a writ of certiorari.

I. Statement of the Case

We confirm the fact that petitioners' (Mor-Flo's) request for a rehearing in banc by the Federal Circuit has been denied -- but note that two of the Judges of that court would have granted a hearing in banc. (A122-3) As far as we have been able to determine from the files of the Federal Circuit, this is the only case in the past two years where two judges have dissented from the denial of such a request, and the Clerk's office can recall no earlier instances.

State asserts that the questions presented in our petition are neither short nor concise and that they are argumentative, contrary to this Court's rule 21.1(a). We believe they comply with this rule.

State also asserts that there is no record support for the fact that the award in this case has inflicted an immense burden on Mor-Flo. While we believe that judicial notice can be taken of this fact, we note that both the amount of the judgment and petitioner's annual reports during the damages period are of record. (See, e.g., A45)

State objects to our citation of a New York Times article but does not contest the wide-ranging impact of the decision below, as noted by that article.

II. Argument

A. Market Share

State asserts that the ruling of the Court of Appeals in this case is not based simply on State's "market share".

This assertion is inconsistent with both the Court of Appeals' observation that it was considering for the first time whether lost profits can be based on market share (A8), and the opening statement by State's counsel before the district court, as follows:

> Mr. Puerner: We're not seeking recovery of profits based on the entire sales made by Mor-Flo. We know that there were other people out there making foam water heaters and making sales. It so happens that at least two of those companies have now been sued under the State patent.
>
> Under any event, there is no question that some of these sales would have been enjoyed by others than State. We have put together an analysis which I think makes good sense and supported by the facts; that is simply that the amount of sales that State lost would be equal to their market share of the Mor-Flo sales. You will hear testimony that State has a strong presence in the market. So that in determining how may sales they would have lost, we submit it would be at least equal to what their market share was in the country taken as a whole.

> This comes out to be somewhere in the neighborhood of 35 to 40 percent. (underscoring added) (A124)

Also, in support of its "market share" claim, State introduced the testimony of its Vice President of Marketing, Mr. Loughrey, as follows:

> Q. Now, have you analyzed the situation to determine the approximate amount of sales which State lost to Mor-Flo?
>
> A. Well, I think that our sales would have increased by about what our market share had gone to in these heaters, which was about 40%, had they been selling fiberglas. (A126)

State then introduced an Exhibit 76 to show its market share, and concluded its examination of Mr. Loughrey. (A126-7)

The portions State quotes from the Court of Appeals opinion do not indicate that the Court's decision was based on factors other than market share. In these portions, the Court observed that the district court made the absence of acceptable substitutes a neutral factor by crediting all other competitors with their market shares -- so that, if anything, Mor-Flo received a windfall and, under these circumstances, the presence or absence of acceptable noninfringing alternatives does not matter. This can follow only if a "market share" rule is adopted. The Court also observed that there is no dispute that State has a 40%

national market share, which also concerns only "market share". Further, the Court observed that State is a national industry leader, with sufficient marketing and manufacturing capacity to satisfy its "market share" portion of Mor-Flo's infringing sales, which again concerns only a "market share" based damages theory. Finally, the Court observed that there was some proof of actual lost sales by State that is not speculative -- which can establish only a minimal portion of the estimated lost profits, and thus confirms that the damages were "market share" based. (Cf. State Br., at pp. 7-9)

From these facts, none of which suggest a quantum of lost sales that even approximates 40% of Mor-Flo sales over the relevant period (i.e., 40% times 754,181 water heaters = 301,672 units), the Court of Appeals ruled that:

> it is eminently reasonable for the district court to infer that State could have sold its market share of Mor-Flo's infringing sales ..." (underscoring added) (State Br. at p. 9; A13)[1]

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1. The purported lost sales referred to by the Court of Appeals involved a price inquiry made to a retailer of State's water heaters in California, by a plumbing contractor who did all the work for a California developer that built 3,000 homes annually. (State Br. p. 9; A114) As indicated in our main brief, while the testimony was that a price inquiry concerning these units was made during 1984-86, there is no indication whether the inquiry was made on the first or last day of the

(continued...)

State asserts that this Court's ruling in Seymour v. McCormick, 57 U.S. (16 How.) 480, 490 (1853), that in a patent infringement suit damages must actually be proved, is dicta -- but that was not the view of the Court in that case or its progeny. Seymour, 57 U.S. (16 How.) at 487-491 (specifically addresses and rejects the jury instruction "that it is a legal presumption that if defendant had not made and sold machines, all persons who bought the defendant's machines would necessarily have been compelled to go to the patentee and purchase his machines," stating instead that actual damages must be actually proved); Cincinnati Gas Co. v. Western Siemens Co., 152 U.S. 200, 204-5 (1894); Rude v. Westcott, 130 U.S. 152, 167 (1889); Dobson v. Hartford Carpet Company, 114 U.S. 439, 444-5 (1885); Root v. Railway Co., 105 U.S. 189, 197 (1881); Corporation of New York v. Ransom, 64 U.S. (23 How.) 487, 490 (1859).

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[1] (...continued)
damages period, or how many units it involved. (Mor-Flo Br. at p. 10, n.4) If the inquiry was after mid-86, Mor-Flo undoubtedly sold only its non-infringing current units to the inquiring plumbing contractor. Indeed, even if it was on the first day of the infringing period (in May of 1984) (which has not been proved), the maximum number of units it could have involved is 6000, which would represent less than 1% of Mor-Flo's infringing sales over the two year period. Nor is there any indication that State's retailer would have got the sale if Mor-Flo did not. Rather, the witness testified that Mor-Flo and Hoyt were the two big water heater manufacturers in Northern California. (A113)

All of the foregoing cases are consistent with the long standing statutory scheme for damages in patent infringement suits, although State is silent as to this factor. (See Mor-Flo Br. at pp. 12-16)[2]

State also asserts that the ruling in this case is not contrary to all previous rulings of the Court of Appeals for the Federal Circuit, citing Central Soya Co. Inc. v. Geo. A. Hormel & Co., 723 F.2d 1573, 1578 (Fed. Cir. 1983) (where the infringer had hired away an employee of the patent owner, who shortly thereafter set up an infringing line, and 80% of the infringer's sales had been to two former customers of the patent owner). In fact, that Court has never before allowed damages based on lost profits where there are available non-infringing alternatives, in the absence of direct proof of the approximate quantum of the loss. Central Soya, supra; Water Technologies Corp. v. Calco, Ltd., 850 F.2d 660, 672 (Fed. Cir. 1988); Radio Steel & Mfg. Co. v. MTD Products, Inc., 788 F.2d 1554, 1555 (Fed. Cir. 1986). Indeed, in Central Soya, the Court noted with approval that there had been an express finding by the district court that there was no acceptable alternative on the market. Central Soya, 723 F.2d at 1579.

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2. As this Court has ruled, the Constitution has ordained that the patent system (which would include any relief to be accorded a patent owner) must be based on the statutory scheme established by Congress. See, e.g., Graham v. John Deere Co., 383 U.S. 1, 6 (1966).

B. Burden of Proof

State asserts that there has been no explicit statement by the Court of Appeals that the burden of proof is shifted to Mor-Flo. (State Br. at p. 10)

While this is true, the rule of this case is that a patentee need only show its market share and a capacity to supply that portion of the infringer's sales, perhaps with some proof of a lost sale that is deemed non-speculative. This being the case, the burden then necessarily falls on Mor-Flo to show that State's sales to Mor-Flo's customers would not have followed State's national market share. This is a burden that never before fell on an alleged infringer, and one which Mor-Flo consequently took no steps to address in this case. That such a major shift in the burden of proof is not explicitly discussed in the Court's opinion does not make it any less unfair.

III. Conclusion

A market share distribution is unjust. It speculates, without proof, that all suppliers would have shared in the infringer's sales according to their respective market shares. It will result in mammoth awards where damages have not been proved, find its way into every patent suit, prevent competitors from risking open and fair competition, and redound to the detriment of American industry.

Further, changing this rule in the middle of the game is grossly unfair, and devastating in its effect on Mor-Flo.

It is urged, therefore, that the petition for certiorari be granted.

Respectfully yours,

COPY (ORIGINAL SIGNED) CHARLES W. BRADLEY

12/6/89

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Petitioner's Supplemental Appendix

INDEX OF APPENDIX MATERIAL

Page

1. CAFC Order denying rehearing in banc, dated November 9, 1989 . . . . . A-122

2. State's Opening Statement A-124

3. Selected Pages From District Court Trial Transcript of the Damages Trial A-125

United States Court of Appeals for the Federal Circuit

89-1032, -1033

STATE INDUSTRIES, INC.,
Plaintiff/Cross-Appellant,

v.

MOR-FLO INDUSTRIES, INC. and
AMERICAN APPLIANCE MFG. CORP.,
Defendants-Appellants.

ORDER

ORDER

A suggestion for rehearing in banc having been filed in this case, and a response thereto having been invited by the court and filed,

UPON CONSIDERATION THEREOF, it is

ORDERED that the suggestion for rehearing in banc be, and the same is, declined.

Circuit Judge Nies and Circuit Judge Bissell would rehear the case in banc.

FOR THE COURT,

/s/

Francis X. Gindhart

Dated: November 9, 1989

Filed
U.S. Court of Appeal For
The Federal Circuit
Nov. 9, 1989

Francis X. Gindhart
Clerk

cc: CHARLES W. BRADLEY
PAUL R. PUERNER

STATE INC. V. MOR-FLO INC, 89-1032, -1033

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Note: This order has not been prepared for publication in a reporter.

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Mr. Puerner: We're not seeking recovery of profits based on the entire sales made by Mor-Flo. We know that there were other people out there making foam water heaters and making sales. It so happens that at least two of those companies have now been sued under the State patent.

Under any event, there is no question that some of these sales would have been enjoyed by others than State. We have put together an analysis which I think makes good sense and supported by the facts; that is simply that the amount of sales that State lost would be equal to their market share of the Mor-Flo sales. You will hear testimony that State has a strong presence in the market. So that in determining how many sales they would have lost, we submit it would be at least equal to what their market share was in the country taken as a whole. This comes out to be somewhere in the neighborhood of 35 to 40 percent. And those are the figures we will present to you with the witnesses. As to the balance of the sixty percent of sales, the statute tells us that the very least -- at the very least, the prevailing patent order should recover as a reasonable royalty.

I am not going to get into the details of this hypothetical negotiation for reasonable royalty. The parties don't disagree that is the way you have to do

MR. LOUGHREY, STATE'S VICE PRESIDENT OF MARKETING

Q Let's move onto the types of customers that are serviced by State and Mor-Flo. Does Mor-Flo sell to the same type of customers?

A Here again, Mor-Flo sells to plumbing wholesalers, margin two-step retailers that sell them to mobile home dealers. So I think in all facets of the business we're head-to-head competitors.

Q Would that be true also of the products themselves, the line of foam insulated water heaters so they have a comparable line to State in '84 to '86?

A I think in all cases they parallel line, yes.

Q Mr. Loughery, in the years 1984 to '86, did State lose sales to Mor-Flo as a result of Mor-Flo's sales of gas foam water heaters?

A I think we did.

Q Is there any doubt in your mind that that happened?

A None at all.

Q Now, will you explain just how you came to this conclusion that you just stated?

A Well, we are head-to-head competitors. I think that had Mor-Flo not had foam heaters we would have sold more. The product is

marketable, more so than a fiberglas heater, and that would be the basis for my conclusion.

Q Now, have you analyzed the situation to determine the approximate amount of sales which State lost to Mor-Flo?

A Well, I think that our sales would have increased by about what our market share had gone to in these heaters, which was about forty percent, had they been selling fiberglas.

Mr. Puerner: I'd like to give the witness Exhibit No. 76 and have him refer to that, please.

Q Would you describe what is recorded or what is shown on plaintiff's exhibit 76?

A Well, the State unit sales are for our sales of foam gas water heater during these periods. The ashrae gamma figures are figures that are compiled by information that's given to gamma audited information given to gamma by all the manufacturers. So that shows the total sales of the type product we're talking about during those years.

Q And the final column on Exhibit 76, what does that represent?

A That shows State's market shares of foam insulated gas heaters during these years.

Q I have no further questions.

The Court: All right.

Cross Examination

by Mr. Stadheim:

Q Did you say that that shows State's market share for foam insulated gas heaters?

A For energy saver -- for foam heaters, yes.

Q Energy saving gas residential foam -- gas residential heaters, right?

A Foam gas residential heaters.

Q But this statistic has to do with energy saving gas residential heaters, not with the foam energy saving gas residential heaters; isn't that right?

A Which statistics are you talking about?

Q The ones you're talking about here.

A I'm talking about State's sales in units.

Q Okay. And that is a percentage of the total ashrae gas residential heaters sold in the United States; isn't that right?

A The last column and to the right,